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Final Regulations Under the Additional Hospital Insurance Tax (0.9 percent) and the Unearned Income Medicare Contribution (3.8 Percent)

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Final Regulations Under the Additional Hospital Insurance Tax (0.9 percent) and the Unearned Income Medicare Contribution (3.8 Percent)

-by Neil E. Harl*

On November 26, 2013, the Department of the Treasury issued final regulations for the two major taxes¹ enacted in 2010 as part of the Patient Protection and Affordable Care Act.² The Additional Hospital Insurance Tax is levied at a rate of 0.9 percent on taxpayers (other than a corporation, estate or trust) receiving wages in excess of \$250,000 on a joint return, \$125,000 for a separate return and \$200,000 for others;³ the Unearned Income Medicare Contribution is imposed on married couples filing a joint return or a surviving spouse who earn more than \$250,000, \$125,000 for those filing separately and \$200,000 for other taxpayers, at a 3.8 percent rate on the lesser of the taxpayers' net investment income or the excess (if any) over the modified adjusted gross income for the taxable year over the threshold amount.⁴ The two sets of regulations made rather minor changes in the proposed regulations issued on December 5, 2012.⁵

Additional Hospital Insurance Tax

The final regulations under the Additional Hospital Insurance Tax provide guidance for implementing the 0.9 percent tax with respect to (1) the requirement to withhold the tax on certain wages and compensation;⁶ (2) the requirement to file a return reporting the Additional Medicare Tax;⁷ (3) the employer processes for adjusting underpayments⁸ and overpayments⁹ of the tax; and (4) the employer and individual processes for repayment or reimbursement by the employer of the tax erroneously collected from employees.¹⁰

Unearned Income Medicare Contribution

The 3.8 percent tax (the Unearned Income Medicare Contribution), while implying that the proceeds go toward Medicare, according to the Joint Committee on Taxation no provision is made for the transfer of the tax to any trust fund.¹¹

The final regulations make relatively few changes that would affect farm and ranch taxpayers. As noted above, the tax is imposed at a rate of 3.8 percent of the lesser of the taxpayer's "net investment income" or the excess (if any) over the modified adjusted gross income for the taxable year over the threshold amount.¹² The threshold amounts are based on filing status. Here are the major issues of concern for farm and ranch taxpayers—

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Next issue will be published on January 3, 2014.

• The statute¹³ specifies that “net investment income” shall not include any item taken into account in determining self-employment income for such taxable year on which a tax is imposed by section 1401(b). The final regulations respect that provision which means that rents received under material participation share rent leases for which the 15.3 percent self-employment income has been paid are not subject to the 3.8 percent tax; rents received under share rent leases for which the 15.3 percent self-employment tax is not paid are likely to be subject to the 3.8 percent tax; and cash rents are also subject to the 3.8 percent tax. Nothing in the regulations addresses so-called “hybrid” share rent leases but the outcome will likely depend upon the extent to which the taxpayer receiving the rents under a “hybrid” lease is meaningfully bearing the risks of production, bearing the risks of price change and providing management input.

The Department of the Treasury, in the explanation accompanying the final regulations, rejected suggestions that a taxpayer who is fully employed by a limited liability company (LLC) or a limited liability partnership (LLP) who materially participates in that entity and who pays self-employment tax, is considered to have met the SE exception.

• The 3.8 percent tax is imposed on estates and trusts¹⁴ to the extent of the lesser of the undistributed net investment income for the taxable year or the excess (if any) of the adjusted gross income over the dollar amount at which the highest tax bracket in section 1(e) begins for the taxable year (which is \$11,950 for 2013, \$12,150 for 2014.¹⁵

The final regulations exclude from the 3.8 percent tax cemetery perpetual care funds, electing Alaska Native Settlement Trusts, charitable purpose trusts” and foreign estates and trusts but U.S. beneficiaries of foreign trusts that accumulate income are subject to the 3.8 percent tax upon the receipt of an accumulation distribution from a foreign trust. Electing small business trusts (ESBTs) are to compare the combined undistributed net investment income (of the S portion and the non-S portion) with the excess of its adjusted gross income over the I.R.C. § 1(e) threshold.

The final regulations are effective for taxable years beginning after December 31, 2013 except that Treas. Reg. § 1.1411-3(d) (applicable to charitable remainder trusts) applies to taxable years beginning after December 31, 2012. Of course, the statute (I.R.C. § 1411) is effective for taxable years beginning after December 31, 2012.

ENDNOTES

¹ T.D. 9644, 2013-2 C.B. __; T.D. 9645, 2013-2 C.B. __. 78 Fed. Reg. 71468 (Nov. 29, 2013); 78 Fed. Reg. 72393 (Dec. 2, 2013).

² Pub. L. No. 111-148, 124 Stat. 119 (2010). See the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

³ I.R.C. § 3101(b)(2).

⁴ I.R.C. § 1411(b).

⁵ REG-130074-11; REG 130507-11.

⁶ Treas. Reg. § 31.3202-1(g)(2) (to the extent the employer does not collect the tax imposed on the employee, the employee is liable to pay the tax).

⁷ Treas. Reg. § 31.6011(a)-1 (the employee who is paid wages subject to the tax is to file a return).

⁸ Treas. Reg. § 31.6205-1(b)(2).

⁹ Treas. Reg. § 31.6413(a)-2.

¹⁰ Treas. Reg. § 31.6413(a)-1(a)(2).

¹¹ Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress 363 (March 24, 2011).

¹² I.R.C. §§ 1411(b), 1411(a)(1).

¹³ I.R.C. § 1411(c)(6).

¹⁴ I.R.C. § 1411(a)(2).

¹⁵ Rev. Proc. 2013-35, 13-2 C.B. 537.

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